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(8) Lack of legal capacity of a party to the transaction incident to which the guaranty or the insurance is granted (§36.4328),

(9) Failure of the lender to see that any escrowed or earmarked account is expended in accordance with the agreement,

(10) The taking into consideration of limitations upon the quantum or quality of the estate or property (§36.4350(b)),

(11) Any other requirement of 38 U.S.C. chapter 37 or the regulations concerning guaranty or insurance of loans to veterans which does not by the terms of said chapter or the regulations concerning guaranty or insurance of loans to veterans result in relieving the Secretary of all liability with respect to the loan,

no claim on the guaranty or insurance shall be paid on account of the loan with respect to which such failure occurred, or in respect to which an unwillful misrepresentation occurred, until the amount by which the ultimate liability of the Secretary would thereby be increased has been ascertained. The burden of proof shall be upon the holder to establish that no increase of ultimate liability is attributable to such failure or misrepresentation. The amount of increased liability of the Secretary shall be offset by deduction from the amount of the guaranty or insurance otherwise payable, or if consequent upon loss of security shall be offset by crediting to the indebtedness the amount of the impairment as proceeds of the sale of security in the final accounting to the Secretary. To the extent the loss resultant from the failure or misrepresentation prejudices the Secretary's right of subrogation acceptance by the holder of the guaranty or insurance payment shall subordinate the holder's right to those of the Secretary.

(c) If after the payment of a guaranty or an insurance loss, or after a loan is transferred pursuant to §36.4318 (a), the fraud, misrepresentation or failure to comply with the regulations in this subpart as provided in this section is discovered and the Secretary determines that an increased loss to the government resulted therefrom the transferor or person to whom such pay-

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ment was made shall be liable to the Secretary for the amount of the loss caused by such misrepresentation or failure.

[13 FR 7741, Dec. 15, 1948, as amended at 24 FR 2654, Apr. 7, 1959]

§ 36.4326 Hazard insurance.

The holder shall require insurance policies to be procured and maintained in an amount sufficient to protect the security against the risks or hazards to which it may be subjected to the extent customary in the locality. All moneys received under such policies covering payment of insured losses shall be applied to restoration of the security or to the loan balance. Flood insurance will be required on any building or personal property securing a loan at any time during the term of the loan that such security is located in an area identified by the Federal Emergency Management Agency as having special flood hazards and in which flood insurance has been made available under the National Flood Insurance Act, as amended. The amount of flood insurance must be at least equal to the lesser of the outstanding principal balance of the loan or the maximum limit of coverage available for the particular type of property under the National Flood Insurance Act, as amended. The Secretary cannot guarantee a loan for the acquisition or construction of property located in an area identified by the Federal Emergency Management Agency as having special flood hazards unless the community in which such area is situated is then participating in the National Flood Insurance Program.

(Authority: 42 U.S.C. 4012a, 4106(a))

[62 FR 5531, Feb. 6, 1997]

§ 36.4327 Substitution of trustees.

In jurisdictions in which valid, any deed of trust or mortgage securing a guaranteed or insured loan, if it names trustees, or confers a power of sale otherwise, shall contain a provision empowering any holder of the indebtedness to appoint substitute trustees, or other person with such power to sell, who shall succeed to all the rights,

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powers and duties of the trustees, or other person, originally designated.

[13 FR 7279, Nov. 27, 1948]

§ 36.4328 Capacity of parties to contract.

Nothing in §§ 36.4300 to 36.4375, inclusive, shall be construed to relieve any lender of responsibility otherwise existing, for any loss caused by the lack of legal capacity of any person to contract, convey, or encumber, or caused by the existence of other legal disability or defects invalidating, or rendering unenforceable in whole or in part, either the loan obligation or the security therefor.

[13 FR 7279, Nov. 27, 1948]

§ 36.4329 Geographical limits.

Any real property purchased, constructed, altered, improved, or repaired with the proceeds of a guaranteed or insured loan shall be situated within the United States which for purposes of 38 U.S.C. Chapter 37 is here defined as the several States, Territories and possessions, and the District of Columbia, the Commonwealth of Puerto Rico, and the Commonwealth of the Northern Mariana Islands.

[46 FR 43673, Aug. 31, 1981]

§ 36.4330 Maintenance of records.

(a) The holder shall maintain a record of the amounts of payments received on the obligation and disbursements chargeable thereto and the dates thereof. This record shall be maintained until the Secretary ceases to be liable as guarantor or insurer of the loan. For the purpose of any accounting with the Secretary or computation of a claim, any holder who fails to maintain such record shall be presumed to have received on the dates due all sums which by the terms of the contract are payable prior to date of claim for default, and the burden of going forward with evidence and of ultimate proof of the contrary shall be on such holder.

(b) The lender shall retain copies of all loan origination records on a VA-guaranteed loan for at least two years from the date of loan closing. Loan origination records include the loan application, including any preliminary

application, verifications of employment and deposit, all credit reports, including preliminary credit reports, copies of each sales contract and addendums, letters of explanation for adverse credit items, discrepancies and the like, direct references from creditors, correspondence with employers, appraisal and compliance inspection reports, reports on termite and other inspections of the property, builder change orders, and all closing papers and documents.

(Authority: 38 U.S.C. 501, 3703(c)(1))

(c) The Secretary has the right to inspect, examine, or audit, at a reasonable time and place, the records or accounts of a lender or holder pertaining to loans guaranteed or insured by the Secretary.

(The information collection requirements in this section have been approved by the Office of Management and Budget under control number 2900-0515)

[63 FR 12004, Mar. 12, 1998]

§ 36.4332 Delivery of notice.

Any notice required by §§ 36.4300 to 36.4375 to be given the Secretary must be in writing or such other communications medium as may be approved by an official designated in § 36.4342 and delivered, by mail or otherwise, to the VA office at which the guaranty or insurance was issued, or to any changed address of which the holder has been given notice. Such notice must plainly identify the case by setting forth the name of the original veteran-obligor and the file number assigned to the case by the Secretary, if available, or otherwise the name and serial number of the veteran. If mailed, the notice shall be by certified mail when so provided by §§ 36.4300 to 36.4375. This paragraph does not apply to legal process.

[58 FR 29117, May 19, 1993]

§ 36.4333 Satisfaction of indebtedness.

Upon full satisfaction of a guaranteed loan by payment or otherwise it shall be the duty of the holder to cancel the endorsement, if any, of the Secretary; and forthwith inform the Secretary of such cancellation. In the event the Secretary's liability thereon is evidenced by an instrument separate